

Australia's retail loan rate changes



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Retail lending is the practice of loaning money to individuals rather than institutions (Investorglossary, 2008). Banks, credit unions, savings and loans institutions, and mortgage bankers are all examples of retail lenders.

Retail lenders are used generally for lending money for mortgages, auto loans and consumer-finance loans (Investopedia, 2008). It is the first time in Australia, over a decade that commercial banks have increased their variable rates independent of a hike in official rates. With automation comes the danger of rapidly magnifying problems, as with the 2007 U. S.

Mortgage Debacle, inflation contraction, etc (Rmaustralia, 2008). A widespread shock in Australia in January when ANZ became the first bank to raise rates beyond the Reserve Bank's rises. The other banks soon followed, making dent after dent in the household budgets of millions of mortgage holders. During that period, the major banks increased their share of the lending market even though they raised their standard variable loan rates in April and July independently of the Reserve Bank of Australia, which raised its rates twice, in February and March (Theage, 2008). The banks have been warning for months that they could not absorb increased borrowing costs that have flowed through global credit markets after the U. S.

subprime mortgage crisis, and have already increased some business rates (Reuters, 2008). This report is constructed to give more understandings about current issue in Australia financial market. Through many research from books, journals, newspapers, and websites, it will tell further about the reasons for Australia banks increasing retail loan rates and the impact of the issue on Australian financial market and its economy. 2. RESERVE BANK

AUSRALIA (RBA) MONETARY POLICY AND CASH RATEThe Reserve Bank of Australia (RBA) as Australia's central bank was established by the Reserve Bank Act of 1959 when it took over the central banking responsibilities from the Commonwealth Bank.

RBA is responsible for formulating and implementing monetary policy. 2. 1. The Operation of Monetary Policy2. 1.

1. Monetary Policy InstrumentsOpen market operations has to offer higher than the bond market rulings price to get a successful bid of the security, in case to ease monetary conditions and it consequently buys bonds from banks. By offsetting the liquidity requirements of the money market, RBA neutralizes the effects which the often erratic, fluctuations in funds may otherwise have on short-term interest rates, in particular the money market dealers pay on market cash rate (Bell, 2004) (see Appendix 2). 2. 1.

2. Indicators of Monetary PolicyRBA sets an operating target for the overnight cash rate, which is the interest rate on overnight loans made between institutions in the money market. The RBA Broad specifies the required target for the cash rate, which influences other interest rates in the economy (Kriesler, 1999). Figure1 shows that there is a strong relationship between most interest rates, especially among shorter maturity. Changes in the cash rate indicate changes in the stance of the monetary policy, with the rises in the cash rate being tightening of the monetary policy, and falls in the cash rate being easing.

The interest rate is relevant to borrowers and lenders in the real interest rate (cash rate minus inflation). High interest rate reflects tight monetary policy,

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and vice versa (Kriesler, 1999). In figure 1, interest rate was starting to increase in recent 6 years. Changes in monetary policy mean a change in the operating target for the cash rate, and hence a shift in the interest rate structure prevailing in the financial system (RBA, 2008). Figure 1 Figure 2 The cash rate is determined in the money market as a result of the interaction of demand for and supply of overnight funds.

The Reserve Bank's ability to pursue successfully a target for the cash rate stems from its control over the supply of funds which banks use to settle transactions among themselves. If the Reserve Bank supplies more exchange settlement funds than the commercial banks wish to hold, the banks will try to shed funds by lending more in the cash market, resulting in a tendency for the cash rate to fall and vice versa (Lewis, 1998). Figure 3 Source: Bloomberg (as at 24 June 2008) Figure 4 Another indicator is the yield curve, the graph of interest rates of different maturities. When short-term interest rates (cash rate) are below long term interest rate (e.

g. 10 year bonds), the yield curve is upward sloping. A downward sloping yield curve reflects the belief that interest rate and inflation will fall in the future, and is an indicator that monetary policy is tight. In figure 3, the downward sloping curve, indicating the tight monetary policy. 2.

1. 3. Goals of monetary policy Bank charter is implemented in section 10(2) of the Act, which states the main concerns: the rate of inflation, the rate of unemployment, and the level and growth of national income (Appendix 1) (Kriesler, 1999). The monetary policy aims to achieve the medium term and to encourage strong and sustainable growth in the economy.

In the long run, this is the principal way in which monetary policy can help to form a sound basis for long-term growth in the economy (RBA, 2008). Higher rate of income growth usually creates higher employment growth. If the RBA stimulates economic growth, the outcome will be too high rate of inflation. If the RBA causes interest rates to be set too low inflation will eventually rise, while if interest rate are set too high economic growth will be stifled (Kriesler, 1999).

2. 2. The Transmission of Monetary Policy to the Economy The linkage from instruments to indicators and goals is known as the transmission mechanism of monetary policy (Lewis, 1998). The cash rates and announcements of the RBA's intentions are used to influence other market interest rates. These affect aggregate demand and thus output, employment, and prices (Kriesler, 1999).

The higher interest rate depresses aggregate demand, which leads to a reduction in output thus to a reduction in demand for labour by firms, then it is expected to effect on price increases, thus slow the inflation rate. A loosening in monetary policy involves a reduction in the cash rate, which should feed through to other interest rates, it should result in an outflow capital from Australia to countries where interest rates are higher. Resulting a reduction in the demand for Australian dollars on foreign exchange markets. These factors lead to a rise in Australian spending and production and a rise in the price level (Kriesler, 1999).

A negative association incurred between interest rates and both demand growth and inflation (Figure 5). Recent years, cash rate and the inflation

occur increasing, but otherwise the growth is declining. Responding to cyclical developments and inflationary pressures, monetary policy has thus had a powerful influence on aggregate demand and inflation in the economy.

Figure 53. Analysis of Changing Retail Loan Rates and The Impacts
The increase in wholesale funding costs due to the US sub-prime crisis has affected banks around the world, as well as Australian banks, forcing increases in interest rates on retail loans (Bankers, 2008). The spread of bank bills swap rates and cash, revealing that Australian banks had become as eager to increase their liquidity and as reluctant to part with it as banks in the US, Europe and the UK.

Australia's major banks were not as dependent on the Residential Mortgage Backed Securities (RMBS) market as many offshore institutions, but securitization had become very much more important in recent years (Businessspectator, 2008). The smaller players in the home mortgage market depended on securitisation as relatively cheap source of funds in the absence of a retail deposit base. When that market closed, it left a considerable hole in the funding of Australian household demand for mortgages. Australian banks raise most of their liabilities onshore, but there is an important role for offshore borrowing as well. Figure
Figure
In the early months of the crisis, the global market has been declining due to lenders were uncertain about the extent of losses in all banks, and were meanwhile seeing the value of their existing portfolios of term bank paper decline. While Australian banks willing to pay a higher spread for short term funding, they were reluctant to pay what to them were unusually high spreads to borrow term until they were convinced the higher term spreads were enduring.

3. 1. The response of the RBA and financial institutions Though Australian banks have large offshore liabilities, they routinely swap their foreign exchange exposure into Australian dollars. Through the second half of last year the banks were able to close existing foreign exchange swaps with the RBA and others to meet foreign currency obligations at a time offshore borrowing was temporarily difficult. While the RBA was active in supporting bank funding in the early months of the crisis, the banks themselves also responded quickly to the change in the funding pattern. This was most immediately evidently in the increased competition for new retail deposits, which have usually contributed about half of bank funding in Australia.

After declining for some time as a share of bank liabilities, deposits bounced back towards the end of last year. By the end of 2007 and the beginning of this year the banks had evidently decided that higher rates would prevail for some time to come. Because major global banks were twist back asset growth and were more interested in supporting their capital base than their lending, demand in offshore funding markets had retreated. In the first quarter of this year the Australian banks borrowed more offshore than in any quarter on record. Through a combination of prompt RBA support and the banks own programs to increase their retail deposits and seize opportunities to borrow offshore, the immediate pressure on bank funding began to fade towards the end of the first quarter of this year. 3.

2. Australia's points of vulnerability Australian financial markets are less stressed than they were at the beginning of the year, that major Australian financial institutions have got through without significant damage, and that the prospective impact of the financial crisis on output growth has not been

sufficient, in the judgment of the RBA, to discourage it from tightening four times since the crisis became apparent at the beginning of August (The Australian Financial Review, 2008). Share prices measured by the ASX 200 index have doubled in the last three years, even taking recent falls into account. House prices have increased 30 per cent over the last three years, and roughly doubled since the beginning of the decade (The Australian Financial Review, 2008). In constructing measures of vulnerability to financial crisis researchers often cite a current account deficit, a rapid increase in credit growth, extensive offshore borrowing, high household debt, a period of rapidly rising asset prices, and rising inflation as indicators of risk.

4. The strengths of the regulatory arrangements, the financial system and the economy. It is evident that despite the apparent vulnerability of the Australian financial system to precisely the kind of crisis which began in August, and despite the fact that many of its manifestations were apparent in Australian markets as soon as they become apparent in the US. There were major cyclical differences between Australia and other comparable economies. The big Australian boom in house prices and sales of established houses, which was quite as formidable as the boom in the US and the UK, ended in 2003. Mortgage loan growth through 2006 and into 2007 was not much less than half the rate evident during the boom.

House price growth had only just resumed, after several years of sluggish movement in median house prices. After a period of sharp decline associated with the housing boom, household savings as a share of GDP were rising through 2006 and into 2007. The credit crisis hit Australia after a period of household balance sheet consolidation. Much the same is true of the home

construction industry. House construction was also quite weak through 2006 and into 2007, with the beginnings of a recovery only becoming evident after a sharp downturn in 2004 and 2005. By the middle of 2007 there was no Australian housing boom to leak.

One of the causes of the housing slowdown was the gradual tightening of the Australian cash rate since 2002. By the middle of 2007 the variable mortgage lending rate was 200 basis points higher than it has been in 2002. Australian mortgages are typically variable rate, the predominance of variable rates and the persistent upward trend in the cash rate, together with the evident slow growth in national median house prices, meant that by 2007 borrowers had already been discouraged from taking on loans they would not over time be able to service (Edwards, 2008). The durability of the investment upswing was underpinned by the unusual incidence of the credit crisis. It began in the US rather than in a less developed economy.

Driven by its own industrialisation, a capital exporter rather than importer, and with a sheltered financial system, China's growth was unaffected. So too, therefore, were the prospects for higher prices for Australian metals minerals and energy exports. Because of strength and durability of output growth, employment growth was quite strong and the unemployment rate had reached and then fallen under a 30 year low. Household incomes were rising quite firmly. 5. Assessing the economic impact The primary channel of influence of a financial shock on the real economy is often the exchange rate, but in this instance the exchange rate against the US dollar has continued the upward trend apparent well before July of last year.

Due to credit crisis much of this Australian dollar strength has reflected US dollar weakness, but even against Euro the Australian dollar remained fairly stable (Edwards, 2008). The credit crisis has certainly exerted influence through the interest rate channel, though it needs to be borne in mind that the RBA has been increasing the cash rate through the episode, now by a total of 100 basis points. Since the most recent RBA increase was at the beginning of March this year, we must assume that it did not assess the impact of the credit crisis on market interest rates to that point as sufficient to achieve the slowdown it sought. The increase in market rates are significant, but not nearly as significant as the increase in the policy rate controlled by the RBA. From the beginning of the episode to now the yield on AAA 1 to 5 year notes has increased by around 120 basis points and the spread over government bonds by a similar amount (Ford, 2005). The standard variable home loan rate has increased 150 basis points, so two thirds of the increase was anyway explicitly sought by policy.

There may well be some channel of influence through business and consumer confidence, both of which have fallen since July last year.

Turbulent market conditions and the collapse of the low-end US mortgage market have affected the value of some CDOs." When CDO products were offered, it was an attractive investment security with a stable and attractive return and an independent AAA rating, however, the US subprime crisis and the global credit crunch has resulted in many CDOs being downgraded and caused substantial write-downs for many global financial institutions and investors." (The Age, 2008) Declining consumer confidence corresponds to the weakness of retail spending volumes in the first quarter of this year, and

perhaps the decline in demand for housing lending and the slowdown in established house price growth in the March quarter (The Australian Financial Review, 2008).

6. CONCLUSION In conclusion, if the housing price continues to decline, many more banks and companies will face bankruptcies. Prices of stocks will continue to decline, as people will not invest their money in high-risk financial market. Economic growth will also slow down due to credit crunch, thus many of the world's central bank will cut off interest rate in an attempt to counter the credit squeeze. Banks will increase rules and regulations in lending requirement, thus making it hard for prime borrowers to make a loan.

Banks in order to lessen the default risks faced when providing loans will impose higher interest rate loan to borrowers. As Australia is not greatly exposed to the effect of the sub-prime crisis, the economic growth will not be much affected. APPENDIX" It is the duty of the Reserve Bank Board, within the limits of its powers, to ensure that the monetary and banking policy of the Bank is directed to the greatest advantage of the people of Australia and that the powers of the Bank ... are exercised in such a manner as, in the opinion of the Reserve Bank Board, will best contribute to:(a) the stability of the currency of Australia;(b) the maintenance of full employment in Australia; and(c) the economic prosperity and welfare of the people of Australia.

" Source: Hunt& Terry, 2008
Diagram 1 Operations of Monetary Policy
Instruments Indicators Goals
Open market operation Cash rate Price

stability-Bond transactionInterest rate spreadsStability of currency-
 Repurchase agreementsMoney supplyFull employmentRediscount
 windowCredit and debt aggregatesHigh output growthForeign currency
 interventionNominal income(Lewis, et. al, 1998)Diagram 2Figure 1Figure
 2Figure 3Source: Bloomberg (as at 24 June 2008)Figure 4Figure 5Figure
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htmlWan, N. (2008, July 17), Home truths force lenders to diversify: Financial Services. The Australian Financial Review, p. 47 Subprime scorches grassroots Vanessa O'Shaughnessy and Marika Dobbin August 20, 2008 LOCAL governments that invested in US subprime mortgage-related assets are holding on to their diminished investments in many cases - because they have little choice. Several councils are considering legal action against Lehman Brothers, although some have ruled it out. Only one council, Wingecarribee Shire Council in the Southern Highlands of NSW, has started legal action.

A spokeswoman for Lehman Brothers said it had received notification of legal action from one council. The products, known as collateralised debt obligations (CDOs), which were sold by investment banks such as Lehman Brothers, were marketed to councils across the country. But turbulent market conditions and the collapse of the low-end US mortgage market have affected the value of some CDOs." When CDO products were offered, it was an attractive investment security with a stable and attractive return and an independent AAA rating," she said.

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“ However, the US subprime crisis and the global credit crunch has resulted in many CDOs being downgraded and caused substantial write-downs for many global financial institutions and investors.” In Western Australia, the City of Albany lost more than \$450, 000 when the resale value of its subprime-related investments fell from more than \$500, 000 to about \$37, 000. Other CDOs held by the council that were valued at \$5. 9 million are now valued at \$4.

2 million. When contacted by The Age yesterday, Yass Valley Mayor Nic Carmody said the NSW council's savings had been diminished, causing it to reconsider a planned upgrade of its sewage works and other capital works. The council has already sold some CDOs at a loss. But it retains others worth up to \$5 million because they continue to generate income. Cr Carmody said Yass Valley Council had relied on the advice of Grange Securities, which later became Lehman Brothers, and on the evaluation of credit ratings agencies. “ You rely on the advice of experts,” he said.

Another council officer from northern NSW said he felt aggrieved at the credit ratings agencies, which proffered AAA and AA ratings on the failed investment products.” The whole process, I think, was a little bit dodgy ...

we are taking the blame for a lot of this where we basically invested under the State Government guidelines,” he said. In contrast, Victoria Teachers Credit Union chief executive William Wolke said the credit union had never bought CDOs of any sort, including those related to the ailing US subprime mortgage market. In stories published last week, The Age incorrectly identified the credit union as having purchased CDOs from Lehman Brothers.

“Categorically we do not have direct exposure to subprime and that’s both in our investment policies and procedures and our lending procedures,” Mr Wolke said. “In fact we are in a very strong position in the market at the moment.

“The situation is different for Orange City Council, which is considering legal action, and for Gilgandra Shire Council, in the NSW Central West.” We’re waiting on advice from solicitors to tell us what our options are for chasing money and, yes, we do have investments placed by Grange Securities and they are affected along similar lines to most councils,” a spokesman for Gilgandra Shire Council said. Manly Council general manager Henry Wong said the council had written down losses of \$400,000 after investing in Federation CDOs and was talking with lawyers and Lehman Brothers about recovering its money. Mr Wong said Lehman Brothers had not disclosed it had an interest in some of the CDOs it was selling nor that the products were referenced by subprime assets.” If we had been told these things before, I can say with almost certainty we probably would not have invested in them,” he said.

Annus horribilis Ruth Williams August 2, 2008 The US subprime crisis has gone from a small cloud on the financial horizon to a raging storm. Ruth Williams reports. THINK back one year. It wasn’t such a long time ago, but things were vastly different. Mortgage interest rates were about 3 percentage points lower than now.

The sharemarket was about 20% higher. The papers were full of stories about booming super returns, and the US “subprime” crisis was like a tiny

dark cloud on the horizon – far away and probably harmless. Fast forward just 12 months. Some of the sharemarket's biggest stars have been reduced to near-worthless wrecks.

Most of the non-bank mortgage sector is in shutdown. The banks have increased mortgage interest rates well above the Reserve Bank's cash rate rises, while in two cases owing up to \$1 billion-plus losses. More companies are closing their doors or drastically cutting staff. In the year to May, according to Australian Securities and Investments Commission figures, more than 3200 companies entered external administration – up almost 25% on the same time last year. In just a year, consumer confidence has fallen to its lowest in 16 years, super funds have recorded their worst quarter since 1992, and, according to Dun & Bradstreet, one in 10 businesses have a high risk of experiencing financial distress, up 11% on the same time last year.

Business confidence is as low as it has been since the 1991 recession. It is now a year since the credit crunch first ravaged the Australian sharemarket. A hiccup in the last week of July last year made way for a 3% drop on the first day of August – which became a rout through the month that stripped 12% off a market that had soared to record highs just weeks before. It signalled the arrival of an era of hard-to-get credit and markets for which volatility is an understatement. “ So much has changed in such a short period of time – it snuck up on many, many people,” says Christine Christian, chief executive of credit reporting agency Dun & Bradstreet. And, in a pernicious case of historical symmetry, this week – the week that marked the credit crunch's unofficial first birthday – has been one of the worst for bad economic and financial news.

Most of it is linked, in various ways, to the US mortgage market and what has become a global crisis. The sharemarket opened with a hangover on Monday; bleary-eyed and in a bad mood after National Australia Bank's confession the Friday before of possible billion-dollar losses in securities linked to the US mortgage market. And things got worse as the week progressed: ANZ's write-down provisions, record negative super returns, freefalling business confidence, warnings from the International Monetary Fund and, locally, hundreds of job losses in a slowing economy. Retail sales for June were the worst in seven years, and credit growth stands at 15-year lows.

Not all of this was a result of the subprime crisis. The dramatic surge in the oil price has flowed through to petrol prices, affecting household budgets across the country, and the drought and global shortages have pushed up food prices. But the spreading impact of what began as "subprime" is clear. "The bottom line is we have an impact on the global economy, flowing through to Australia, from the credit crisis coming out of the US subprime," Prime Minister Kevin Rudd said yesterday, in an official statement of the obvious. The outlook is so uncertain that few are willing to make predictions - except that the economy will continue to slow over the next 18 months.

Talk has now turned to interest rate cuts. And it is unclear when the liquidity crisis that sparked these issues will lift. "I don't know whether we are halfway through, or whatever," says Simon McKeon, the executive chairman of Macquarie Bank's Melbourne office. "It's a very serious problem, and the more serious the problem, the more difficult it is to determine how long it will last." The background to this transition is well known.

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A US real estate boom became a bubble, fed by investment from the oceans of money then washing around the world from pension funds, sovereign funds and various other sources – the global savings glut. The International Monetary Fund estimated that this pool of money was worth \$11 trillion in 2005. Some of that money was parked in private equity vehicles, sparking the leveraged buy-out frenzy that saw Myer and part of the old Publishing and Broadcasting Limited – and almost Qantas – fall into private equity hands. Some of that money was also parked in the frothy US mortgage market. Investment bankers worked out how to slice and dice millions of less-than-marginal mortgages and somehow turn them into rolled-gold AAA-rated securities.

Initially, such securities were based on loans granted to people with jobs and assets. But as the demand for the securities grew, people without jobs and assets were given loans to keep feeding the market. This process reached its peak in 2006 and, soon after, the subprime loans started defaulting on a large scale. Now loans rated above subprime are also defaulting. It took some time to have an impact on Australia. For the first six months of last year, the world nervously watched the US housing market.

The sharemarket wobbled a bit, but “ subprime” remained a distant threat. In late July, the sharemarket reached a then-record 6400-plus. Reality hit hard. On July 27, 2007, the Australian market lost 3% of its value in one day, following a plunge on Wall Street after shockingly low US house sales figures for June. But the real pain came in August. “ People in the capital markets talk about pre-August, post-August,” says Geoff Wilson, chief executive of KPMG.

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“ That was when subprime started to hit. You could see an earthquake coming and it played out soon after that, and it had all sorts of implications right across the markets.” Suddenly, bad news was everywhere. In early August, the RBA raised rates for the first time in nine months - the fifth time since the 2004 election.

RAMS Home Loans' profit warning came in mid-August. Non-bank lender Bluestone jacked up its interest rates above the RBA increase due to the higher cost of borrowing, and others warned that they might have to do the same. Talk had turned from subprime to “ credit crunch” - meaning there was no credit. Liquidity had, well, dried up.

And a series of surveys and data revealed signs of stress in the Australian mortgage market. A Fujitsu Consulting study concluded that as many as 70, 000 households in Australia were in severe danger of defaulting on their mortgage. A Fitch Ratings report ranked Australia third in the world in terms of household debt vulnerability. And census figures indicated that 140, 000 Victorians were under mortgage stress.

“ Our data was telling us back in July that this just can't last forever,” Christian remembers. “ It felt to us like just before the introduction of the GST in 2001. Payment days started to expand out - that's generally the first sign of any financial distress. We started to see an increase in the number of defaults, particularly around mobile phone debts and credit card debts. It happened pretty suddenly.” Twelve months later, and the changes have been immense - beginning with the fallout from a severely shaken sharemarket.

“ Falling share prices have a big role in determining business confidence,” says ANZ chief economist Saul Eslake. “ We are seeing falls (in confidence), which are now very large by historical standards, which are increasingly reflected in the hard data.” And lower share prices also mean lower super returns, at least in the short term. For the June quarter, super returns were the worst since compulsory super began in 1992.

It would be the first time millions of Australians would see their fund go backwards, Superannuation Minister Nick Sherry acknowledged in a radio interview. “ And this has been caused, of course, by the US subprime financial crisis, which has hit the stockmarkets worldwide, very hard,” he said. Other changes? Many non-bank mortgage lenders have all but closed for business. Wholesale funding is more expensive, and the mortgaged-backed securities market has collapsed. Last year, some \$47 billion of Australian residential mortgage-backed securities were sold. In the past six months, this has shrunk to slightly less than \$2 billion.

“ It's had quite a devastating effect on the mortgage industry,” says Joshua Gans, a professor at Melbourne Business School. “ Now the big banks are the only ones who are able to loan in any significant volumes. We have lost competition.” The most high-profile victim was RAMS Home Loans, whose profit downgrade contributed to the start of the August panic. It was struggling to refinance its debt just weeks after floating at \$2.

50 a share. Its founder, John Klinghorn, has pinpointed the moment things changed at August 9, 2007, when French bank BNP Paribas halted withdrawals from three of its funds, saying it could not “ fairly” value

subprime assets held in the funds.” Up until Thursday (August 9, 2007), life was cool for us,” Klinghorn said in late August. “ The market was clearly in turmoil in subprime. We are not in subprime. On Thursday, things changed.

It was suddenly impacting everyone.” Westpac “ rescued” RAMS by buying the group’s brand name and franchise operations for \$140 million. A host of other high-profile victims have spooked investors, dragging the market down further. Hedge fund Basis Capital went under after its subprime investments became worthless. The incomprehensible structure of Centro Properties Group and its subsidiaries obscured a big hole of debt, it emerged in December.

And then there were the margin lenders – Lift Capital and Opes Prime both collapsed, Tricom Equities came close. And the reputations, profits and share prices of two of the big banks have been severely eroded. NAB, it turns out, invested heavily in on-the-nose US mortgage-backed securities, known as collateralised debt obligations (CDOs). They were triple-A rated, NAB says, but this counted for little when no one else was willing to buy the things.

Last week, NAB flagged that it would probably write off 90% of the value of those CDOs – an amount that could reach \$1.01 billion. No other institution, it is believed, has written off its CDOs to such an extent. And ANZ’s losses may exceed \$1 billion over just six months. Its full-year provisions stand at \$2.2 billion, including those linked to wider economic conditions in New Zealand and Australia.

It lost some money through Centro, some through Bill Express and some through Opes Prime. In fact, it lost money on most of the casualties of the

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past year. Ratings agencies have warned this week that NAB's debacle may push up its cost of funds even higher - costs it may have to pass on to consumers. And here is another consequence of the credit crisis: higher mortgage rates.

There was widespread shock in Australia in January when ANZ became the first bank to raise rates beyond the Reserve Bank's rises. The other banks soon followed, making dent after dent in the household budgets of millions of mortgage holders. The banks are paying more for the portion of their funding they source from wholesale credit markets, and they say they have no choice but to pass the costs to consumers. This, with petrol, has had a major impact on consumer confidence.

But the RBA has indicated that, were it not for the banks' extra rate rises, it would have lifted the official cash rate higher to cool what was once an overheated economy. The banks have, in effect, done some of the RBA's work for it." The Australian economy would have been slowing anyway as a result of higher interest rates, whether there had been a subprime market crisis or not," Eslake says. " It just would have meant more of a response from the RBA instead of the commercial banks." But this is scant comfort for Treasurer Wayne Swan, who has pleaded for the banks to show restraint. Indeed, in another consequence, the credit crisis has coloured the first months of the Rudd Government.

" This is not the greatest time to start off being in government, that's for sure," says Gans. In response to rising mortgage rates, Swan is trying to legislate to make it easier for customers to switch lenders. In response to

collapses such as Opes Prime and Lift, Sherry is shoring up market regulation. The Federal Government is moving to centralise regulation of various lending practices. First-home saver accounts will soon be launched to help those trying to break into the market.

Labor has been scrambling to tackle the effects of subprime, almost since it was sworn in. That same fate – on a much bigger scale – awaits whoever wins the US presidential election. There was news last month that, during the three months to June, one in every 171 US home owners lost their house to foreclosure, received a default notice or was warned of a pending auction. That's up 121% on a year ago, and 14% on the March quarter, according to US researcher RealtyTrac.

Geoffrey Garrett, chief executive of the US studies centre at the University of Sydney, says the subprime disaster has undermined the US's confidence in its own enterprising spirit – just as the dotcom collapse did eight years ago." The big difference between subprime and dotcom is that subprime wasn't only Wall Street, it's also Main Street. It has hit America in its heartland," he says. McKeon believes the world economic order is fundamentally changing. Developing countries are more economically powerful and the once-mighty US is headed for a likely recession.

" In most of my time it has been the US first, daylight second," McKeon says. " We are seeing a very awkward period of adjustment as the US identifies for itself where it now belongs, and there's lots of fallout." And what could that mean for Australia? Garrett believes the post-subprime and post-Iraq US will be more insular and more protectionist. It will be less willing to take the lead

on global issues it's perhaps spelling bad news for Rudd's gamble that the US will follow Australia (and Europe) in an aggressive market-based solution to climate change. Will things get better? Of course they will, McKeon says. He's just not sure when.

"I have no doubt that we are simply in another downturn that will be followed by a period where there's much more confidence," he says. Some believe the market meltdown has been a good thing, in some ways. "The message has got to be that we are actually back to the market environment where volatility and risk are behaving the way they should be," says Nick Kalikajaros, the head of Credit Suisse Private Banking in Australia. "The volatility we are seeing in the equity markets, even allowing for the impact of the global credit crisis, should not be viewed as unusual. We seem to have a short memory.

In the last 15 years, I'm not sure people actually respected the risks they were taking for the returns being achieved in their investment portfolios, because they didn't see the downside."